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Abstract:

*Tiongson examines **Poland's** relationship with the **IMF**. **Poland** was the first post-communist country to adopt a radical stabilization and restructuring program and the first to recover from post-reform recession.*

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POLAND AND IMF CONDITIONALITY PROGRAMS: 1990-1995*

With the collapse of communism in 1989, the International Monetary Fund (IMF) found itself in a situation without historical parallels. A large number of new countries required immediate stabilization and liberalization, with economic systems sharply different from a free market system. Because Poland was the first to adopt a radical stabilization and restructuring program and the first to recover from post-reform recession, its relationship with the IMF is of particular interest, both to other transition economies contemplating viable strategies and to post-cold war economic literature rethinking the IMF role in the international policy process. IMF OBJECTIVES

Following the Bretton Woods Conference in 1944, the IMF was founded in 1945 to regulate the postwar international monetary system. As assigned by the Conference participants, the three main functions of the IMF include: (1) the administration of a code of conduct concerning exchange rate policies and restrictions on payments for current account transactions; (2) the provision of financial assistance to member countries correcting imbalances; and (3) the creation of a forum for continued international consultation and cooperation.

While the IMF's main task of promoting international trade and balance of payments equilibrium is in theory, a politically neutral task, this does not mean that IMF negotiations have no political undercurrents. For James Bjork (1995) every economic program is intimately linked with domestic political issues. Managing directors' votes, weighted relative to the size of their home country's contribution, are inevitably linked with broader political considerations - such as the human rights record of a recipient country, its political alliances, its environmental track record, and so on. As James Mayall (Taylor, 1988, p. 53) stresses, the institutional purpose of postwar economic cooperation was to safeguard liberal capitalism.

The IMF is currently active in two areas: exchange rates and international liquidity. Since 1971, the

IMF has lost formal control over exchange rate movements but member countries are still obliged to certain rules of good economic conduct, as prescribed by the IMF. Member countries are also given borrowing or drawing rights from the IMF's resources - consisting of a pool of currencies and international reserve assets, including SDRs (Special Drawing Rights, a new reserve asset in the form of bookkeeping entries) that they can use to help finance a balance of payments deficit. IMF

CONDITIONALITY PROGRAMS

Since the 1970s, the IMF has functioned mainly as the manager of foreign exchange crises and organizer of international debt agreements. The IMF's approval of debtor countries' economic policies has also become a precondition for other debt agreements, as commercial banks and official creditors link rescheduling agreements to IMF-endorsed creditworthiness. Both IMF conditionality lending and cross-conditionality lending (involving commercial banks and official creditors) refer to the process in which countries receive loans on the basis of a promise to enforce a set of IMF macroeconomic prescriptions. These macroeconomic measures concern stability in the short and medium term. The IMF, as regulator of international economic order, is neither centrally concerned with economic growth nor equity. Thus, policy objectives and performance criteria are related to internal and external macroeconomic stability and have less to do with restructuring and redistributive justice.

IMF prescriptions for correcting balance of payment problems invariably include a sharp recession aimed at stabilizing prices and promoting trade balance. For the IMF, links between inflation and external imbalances are strong. Inflation creates overvaluation, erodes the tax base, depresses foreign investment, and promotes capital flight. As Stanislaw Gomulka (1991) puts it, the IMF is an "institutional guardian of low inflation," with its own credibility among member countries inextricably linked with the discharge of such a role.

The standard IMF solution to stabilization problems is to attack inflationary roots directly, mainly through a substantive cut in the budget deficit and devaluation. These two measures are intended to both dampen domestic demand and improve current account balances. Accompanying them are policies such as the liberalization of imports and exchange controls, the elimination of price controls, and the raising of interest rates. Real wages must also fall. In theory, all these measures are meant to reduce the role of government, stabilize prices through slower monetary growth, promote efficiency and competitiveness and balance of payments stabilization through increased exports and foreign investment.

As recessionary economic measures, these IMF stabilization policies have expectedly been unpopular because of the massive social costs involved. As such, analyses of the stabilization experience in various countries have concluded that authoritarianism is a necessary condition for successful IMF-supported stabilization (Cardoso and Helwege, 1992, p. 169ff.).

It has been argued in turn that democracies often enjoy legitimacy and popular support, unlike authoritarian regimes. Furthermore, people in the midst of deteriorating economic conditions may often be willing to try a radically different approach to economic management.

Nevertheless, to many people undergoing the rigors of IMF austerity programs, the IMF's relationship with their government is plain domination. And a long history of aborted stabilization programs, amid popular unrest, may be best understood within the framework of a diktat theory of IMF negotiations.

IMF conditionality itself may be limited in effectiveness, however, because of enforcement difficulties. According to Jeffrey Sachs (1989, p. 278), both theoretical work and empirical evidence establish that

the main method of enforcement, the threat of a lending cutoff, is a credible but limited sanction. For one, the debtor government itself, given an administrative system with diffused responsibilities, may lack the authority to carry out the agreement. Domestic constraints may then provide a leverage for negotiators of a recipient country. More important, in cases of extreme indebtedness, a country may find itself better off suspending stabilization and adjustment programs. Official creditors themselves may find an imminent debt default too costly. Debt reduction, and more relaxed IMF performance criteria, may be of net benefit to both parties. IMF-SUPPORTED PROGRAMS OF POLAND, 1990-1994

Bjork (1995) traces the beginnings of Poland-IMF relationship: An original member of the Bretton Woods institutions, Poland eventually withdrew its membership, frustrated by a much-delayed and stringent reconstruction loan conditionality and the political hostility of the United States. Between 1950 and 1989, Poland periodically expressed interest in renewed IMF membership and in economic and political reform. Consistent commitment to liberal reform, though largely rhetorical, finally led to the approval of Poland's membership in the IMF and the World Bank (WB) in 1986. No significant progress was made toward making the Polish economy more market-oriented, however. For Bjork (1995), this was due mainly to popular resistance to reforms, the absence of government coordination and direction, and resistance to political liberalization.

In 1989, what was formerly an authoritarian Soviet satellite, forever aspiring to fundamental economic restructuring while lacking the political will to fulfill it, had become the leader in a regional breakaway from communist rule. For much of the Western world, reinforcing its ideological and strategic triumph by guaranteeing Polish welfare was imperative. A month into the Solidarity government of Prime Minister Mazowiecki, \$1.2 billion in financial and technical assistance to Eastern Europe, most of it for Poland, had already been committed by the US Senate. Meanwhile, the European Community also pledged \$660 million in economic assistance.

In an IMF and World Bank meeting on September 26, 1989, US President George Bush endorsed the idea of cross-conditionality, specifically the idea of using the IMF as "gatekeeper" of Western economic aid. The primacy of macroeconomic issues rather than institutional and structural reform allowed the IMF to assume the leading role in Polish stabilization and restructuring. The Mazowiecki government itself announced a sweeping program of rapid economic stabilization, effectively accepting the challenge of IMF cross-conditionality and going even further than IMF prescriptions covering the right macroeconomic conditions for growth. Despite popular resistance, rapid deterioration of macroeconomic conditions had made people more amenable to recessionary policies.

The Balcerowicz Plan, also dubbed the "shock therapy" package, went into effect on January 1, 1990, and included, among other policies: rapid price liberalization, elimination of subsidies, increased interest rates, taxing of excessive wage increases, and the complete convertibility of the zloty, its sharp devaluation, and the stabilization of the exchange rate at a sustainable level. A scrutiny of the Balcerowicz program would show that the Polish stabilization plan completely matched traditional IMF conditionality lending. The sole potential source of conflict was the sequencing of measures. With Poland attempting an unprecedented move toward a market economy from an industrialized command economy, the Polish team had enough leverage to argue that exchange rate and price stability should take precedence over balance of payments consideration. The control of inflation thus became a key performance criterion. The IMF, institutional guardian of low inflation that it is, accepted the Polish government-prescribed sequencing.

A standby agreement with the IMF, providing \$700 million in financing was concluded a month after. With the standby agreement also came an additional \$360 million in World Bank lending, as expected.

Realizing that Poland's democratic legitimacy, strategic priority (as the geographic gateway between the West and the Soviet Union), and economic daring, resoundingly endorsed by the IMF and the US, provided an unprecedented bargaining leverage, the Polish government put forward other, bolder requests - among them, a \$1 billion stabilization fund to be provided by its Western economic supporters and the drastic reduction of debt owed to Western creditors.

The stabilization fund was immediately put in place by January 2, 1990. On March 18, 1991, after a long series of dissensions and renegotiations among creditor countries, the Paris Club finally offered Poland an immediate 30 reduction of its debt overhang, conditional on its having IMF-supported programs (already agreed in principle at the time of the announcement). The second tranche of 20 would be released with the successful fulfillment of the performance criteria set by its 36-month Extended Fund Facility (EFF) agreement with the IMF - including a targeted inflation rate of 36, the privatization of 50 of SOEs by 1993, and the acceleration of banking, tax, and trade reform. Meanwhile, the US and France also announced the write-off of an additional 20 and 10 of Poland's existing debt burden.

Discrepancies suspended IMF financing, only a few months into the EFF program. The Balcerowicz program had also become increasingly unpopular. Surprisingly, even with popular discontent, the Polish government neither abandoned the core objectives of the program nor broke with the IMF. Recognizing that continued external financing was crucial and believing themselves that an expansionary economic policy would simply stifle the transition economy, Polish authorities remained committed to IMF-supported stabilization and restructuring.

Negotiations with the IMF reopened in March 1992, with the IMF relaxing its performance criteria, including its tolerance level for the budget deficit and the inflation rate, and showing greater respect for real economic constraints faced by the Polish government. For Gomulka (1995), the more flexible IMF position was arguably influenced by the course of events in the transition economies of Europe experiencing economic crisis and deterioration. On November 24, 1992, a new standby arrangement was officially concluded. Contingent on Poland's compliance with the more conservative performance criteria - among which was budget deficit ceiling at 5 of GDP in 1993 and an inflation ceiling set at 36 IMF financing of \$700 million was to resume and the second tranche of Poland's Paris Club accord was to be released.

Post-communist parties consequently triumphed at the 1993 Sejm election. Amid social unrest, the parliamentary election was widely seen as the registration of Polish voters' dissatisfaction with IMF-backed austerity programs. Soon after, however, the new government, elected on populist promises, itself showed a commitment to stay the macroeconomic stabilization course, even calling for a further deficit reduction to 4 from 5. In 1994, the IMF's approval of the government budget led to the release of a \$500 million standby credit. The IMF approval also released the promised second tranche of the Paris Club accord. International confidence has since paved the way for a substantial debt reduction agreement with its commercial creditors, namely the London Club. RESULTS

Successive renewals of standby programs and increasing external credit worthiness as shown by significant debt forgiveness by the Paris Club and the London Club clearly show Polish success in meeting the IMF-set performance criteria (Table 1). Most of the six performance criteria of the 1990 Standby Program were sufficiently met - including a budgetary surplus, a balance of payments surplus, a stabilized zloty (after the initial devaluation), wage restraint. The rate of inflation was the one indicator that failed to meet the 1990 Balcerowicz-IMF target. Meanwhile, the EFF program for 1991-1993,

though suspended a few months after its approval, had provided the 30 debt reduction by the Paris Club, conditional simply on having an IMF-supported program. For analysts like Gomulka (1995), the failed EFF thus served an important purpose.

The more conservative performance criteria of the 1993 Polish Stand-By were comfortably met in 1993, as Table 1 shows: Government deficit was kept at 2.9 of GDP and consumer prices were at 35.3. There has also been sustained decline in inflation rates, which were at hyper inflationary levels at the start of the transition programs. The Polish Stand-By for 1994-1995 is still ongoing but available economic indicators show a decreased inflation rate, a 5 increase in GDP, budget deficits kept at 2.5 of GDP, and a reduced budget deficit.

	1989	1990	1991	1992	1993	1994
Government Budget (in percent of GDP)	-2.5	+3.1	-6.7	-6.6	-2.9	-2.5
Consumer prices (percent average)	255.1	555.6	70.5	45.0	35.3	32.2
Trade balance (in billions of dollars)	0.2	2.2	0.1	0.5	-2.3	-0.8

TABLE 1

[Enlarge 200%](#)

[Enlarge 400%](#)

Critics of the IMF-supported programs from 1990-1994 invariably point to the output decline in 1990 and 1991 (Table 2). For them, the most telling indication of failure has been the production costs of the recession. Output has since picked up, however, and is almost back to its pre-1990 level. Opinions also vary on how to interpret the output decline. One way of viewing the decline is that output figures cannot be taken at face value. As Poland moved from a shortage economy into a market-clearing economy, most of the output eliminated was essentially excess inventory or "scrap" (Winiecki, 1995). Demand side contraction induced by disinflation and the credit crunch resulting from tight monetary policy may have also contributed to the decline (Calvo and Coricelli, 1993).

According to Georg Winckler (1995), output decline is linked less with the credit crunch than with the collapse of the Soviet Union and the loss of Soviet markets for Polish output. The output decline may also be demonstrated to have started even before the therapy program, as Table 2 shows: From a 4.1 GDP growth (1988, not in table 2), growth decreased to 0.2 in 1989. Trade liberalization and the privatization program started in cooperation with the World Bank may have also affected the output rate, although to a more limited extent. For Winckler, the shock therapy then remains vindicated despite massive output decline. For others like Gomulka (1995), pointing to large costs in the Polish program also seems wrong in view of the even larger output falls that occurred in transition economies that adopted a more gradual approach to stabilization.

The more tangible and lasting costs are the programs' social repercussions, making the sustainability of transition programs highly suspect, for much of the Polish electorate. Unemployment, officially zero before 1989, is currently high at 16.0 and Carol Graham (1994) estimates that poverty, virtually unknown before the transition, is currently affecting 15 percent of the population. For Graham, the urgency of addressing the social cost of economic reform is no better illustrated than the 1993 parliamentary elections registering the dissatisfaction of the Polish people. Graham advises the creation of safety nets to maintain a minimum social welfare standard, such as a social fund and a public works program, until steady sustainable growth is achieved by ongoing economic reforms.

The IMF, however, is primarily concerned with macroeconomic stabilization and the creation of conditions for adjustment, restructuring and steady growth. Criticisms pointing to massive social costs, when IMF programs have little to do with the redistributive impact of stabilization, may then be

arguably misguided. Even the roots of social costs themselves may be traced, not to the austerity program alone, but to the absence of viable welfare nets. More important, these costs may be a blessing in disguise, in the long run. Poland's relatively cheap and skilled labor is currently attracting foreign companies seeking a cheap production base (Robinson and Bobinski, 1995 and International Financial Statistics Yearbook, 1995). Poland, in fact, experienced a substantial growth in investments in 1994. Low wages also continue to dampen domestic demand for imports, thereby pushing export production to 38 percent over the first eight months of the current year (Robinson and Bobinski, 1995). Estimates also point to a 6.5 percent rise in GDP this year (Robinson and Bobinski, 1995). And though privatization efforts remain incomplete at 20 of SOEs (Economic Survey of Europe in 1993-1994), Poland thus far has established the largest private sector in the region. The boom in the Warsaw stock market is also widely seen as an emerging awareness of the benefits of privatization. EVALUATION

	1989	1990	1991	1992	1993	1994
GDP (percentage change)	0.2	-13.0	-7.8	2.6	3.8	3.0
Monthly wages (period average)	281.8	185.9	73.8	39.2	33.8	36.3
Unemployment (percentage)		6.3	11.8	15.0	13.7	16.0
Gross Investments (percentage change)	-2.4	-10.1	-4.1	0.7	3.2	6.6

TABLE 2

[Enlarge 200%](#)

[Enlarge 400%](#)

The Polish-IMF relationship provides an ongoing experiment relevant to transitional economies undergoing stabilization and restructuring programs. As a textbook case of conditional lending, the Polish experience demonstrates familiar features of conditional stabilization programs, even in the post-cold war era. First is the unpopularity of the austerity programs. In Poland's case, the government repeatedly found itself confronted by an angry Polish electorate. Since 1993, former communist leaders and candidates riding on populist promises have been elected into office.

The Polish experience also exemplifies the political leverage that a recipient country, given the limits of conditionality, may enjoy. As they carried out unprecedented economic transition programs, Polish authorities naturally had the dominant view in matters of sequencing, given their greater familiarity with domestic conditions. The failed 1992 EFF program also eased the performance criteria set by the IMF in the 1993 Stand-By Agreement, with the IMF more ready to acknowledge the economic constraints faced by Poland. Realizing the strategic and symbolic significance of its transition program, Poland expectedly exploited even more its leverage and creditworthiness, successfully negotiating a \$1 billion stabilization fund and a substantial forgiveness of its official and commercial indebtedness.

Debt reduction as a precondition for stabilization measures is also illustrated well in the Polish experience. With the 50 and 30 reductions of its indebtedness to the Paris Club and the London club, respectively, no debt overhang threatened the feasibility of recessionary policies.

More than simply a textbook case of conditional lending, however, the Polish experience shows what Kiguel and Liviatan (1992) have found to be crucial to any stabilization program in the long run - namely, the persistent adherence to some core objectives promotes a government credibility needed to see a program through. Neither authoritarian nor a popular democratic government, the 1990-1995 Polish governments nonetheless have constantly promoted unpopular stabilization measures. The political costs have been definitive and considerable, with former communist leaders elected back in power. More recently, Lech Walesa lost the presidency to Alexander Kwasniewski, a former junior minister in the communist regime.

But as Brooke Unger (1994) put it, reform has proceeded despite democracy. Leaders elected on populist platforms have continually kept basic principles of the Balcerowicz program. For Bjork (1995), even without IMF conditionality, Poland would still have continually formulated an austere transition program because of deteriorating macroeconomic conditions. Stabilization takes time and perhaps only a continued commitment to sustained, often painful, transition policies can create the necessary conditions to steady economic growth. In Poland's case, it has certainly eased the recovery from transition recession, the sustained decline in inflation, and the increased inflow of foreign investment.

Certainly not without substantial IMF concessions. While it may be true that Poland enjoyed political leverage over most of the negotiations, IMF gradually relaxed its criteria, providing steady and generous financial assistance in the process. The Polish program itself, as originally designed by Balcerowicz, is a standard IMF stabilization model, easing much of the negotiation progress. Equally important, the generous debt relief agreement and the substantial bilateral assistance generated by Western creditors, have continually provided crucial external financing to Poland's transition economy.

The key point is that relationships between international financial institutions and national governments need not be confrontational but rather, a consistent cooperative venture at solving specific, sometimes unprecedented, political and economic problems. Less central but no less important are lessons in viable safety nets, appropriate privatization, and more accurate measures and evaluation of real output decline.

Yet neither is Poland's economic experience completely generalizable to other transition economies. A similar shock therapy may provide the momentum and credibility needed by these economies, according to Winckler (1995), but the Polish economic programs may still have too fluid an outcome to provide replicable features. As Ben Slay (1994) points out, state-owned enterprises have resisted restructuring programs, budget deficits have persisted since 1991 and the banking system's problems remain unsolved.

It is highly doubtful, too, whether other transition economies may realistically expect the same substantial debt cuts and bilateral assistance received by Poland in 1992 and 1993. Global euphoria over the collapse of communism has generally subsided, transition economies have lost much of their novelty, and no other Eastern European economy would assume the strategic and symbolic position held by Poland in the early 1990s. Much of post-cold war lending is currently tied to highly diversified bilateral priorities.

There is a sense then in which every country's collaborative effort with the IMF is always unprecedented. If there is a lesson to be learned in post-cold war politics, in a world where alliances and identities are continually being redefined along fluid lines and where command systems as well as political categories have collapsed, it is, perhaps, this - that nothing is ever completely generalizable. The intricate interplay between IMF conditionality and recipient country leverage should continue to assure a collaborative effort at coming to terms with the specific realities of specific economies.

[Footnote]

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[Author note]

Erwin R Tjongson Georgetown University

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